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Final Report
Task Order #10: Training for the Ministry of Social Insurance



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Introduction

The purpose of this report is to summarize the activities related to the training programs on Social Insurance Reform in Egypt that were conducted during May and from mid-September to mid-October (2000) in Cairo. These training programs were funded by USAID under the TAPR technical assistance program. This report details the training objectives and activities, participant evaluations, and recommendations for follow-up activities. The current phase of training activities culminated in a one-day policy workshop on February 26, 2001.

These training programs were preceded by a technical support and training phase of activities funded by USAID and conducted by a team of local and foreign consultants under the TAPR technical support project during 1998-1999. The report issued by TAPR made an assessment of Egypt's current Social Insurance System (SIS) and included a specific discussion of enhancements that would improve its effectiveness and prepare it for the expected demographic challenges of the 21st century.

A central theme in these recommendations is the adoption of a diversified, multi-pillar approach for providing social insurance in Egypt that includes mandatory and voluntary private pension plans with personal, defined contribution accounts. The development of such a multi pillar pension system would also serve to broaden and deepen the Egyptian capital markets and thereby serve to strengthen the long-term financial basis for the pension system. The training conducted in this phase of activities focused on enhancing the skills of officials and workers involved in Egypt's current social insurance system and preparing them for implementing such an approach in Egypt.

Objectives of Training

The objective of the training program was to provide training to the Ministry of Social Insurance (MOSI) staff and other government officials from the National Investment Bank, Ministry of Economy, Ministry of Finance, and Capital Markets Authority on pension reform and the related issues concerned with investment options for pension funds. The training program was intended to support and accelerate the implementation of the enhancement recommendations proposed in the MOSI-TAPR Action Plan developed in 1998-99. These recommendations include the development and operation of an enhancement management team within MOSI, the launching of a legal and regulatory initiative, the creation of defined contribution pension plans (Pillars II and III), and the implementation of a public awareness program. It was hoped that the realization of these objectives would result in increased retirement benefits for Egypt's working

population, increased employment opportunities, stronger capital markets, and economic growth across all sectors of the economy.

The specific objectives of the training program included:

- How to analyze current and future problems with “pay-as-you-go” social security systems
- Understanding the evolving body of international best practices and their relevance for Egypt.
- How to design an overall strategy for social security and pension reform, including technical, financial, social, legal, and institutional considerations.
- How to improve benefits for retirement and strengthen financial systems.
- How to design and draft laws and regulations for private pensions to protect workers and pensioners.
- How social security and pension reforms are linked to other economic reforms including privatization and capital markets development.
- How to initiate private sector participation in the creation and management of private pension plans.
- How to manage private pension plans.
- How to manage the MOSI current fund invested in the stock exchange.

Description of Training

The training program consisted of two phases. Phase I was titled “Developing Strategies to Enhance Egypt’s Social Insurance System” and was conducted from May 7, 2000 to June 1, 2000. Phase I training consisted of four one-week training programs, the technical content for each week’s program was the same. Approximately 35-40 participants attended each week. The material provided for the workshop was translated into Arabic and simultaneous translation was provided for oral presentations.

The technical content for Phase I included:

- Understanding the Key Elements of Social Security Systems.
- Key Concepts and Issues for Social Security and Pension Design: Identifying Future Challenges and Understanding the Need for Reforms.
- Improving and Strengthening a Social Insurance System: Diversified Multipillar Systems.

- Legal and Regulatory Framework for Social Security and Pensions.
- Developing Private Pensions in an Egyptian Context.

Case studies of recent pension reforms in Poland, Chile, Argentina, Kazakhstan were also presented. Significant time was devoted to lively discussions of Egypt's social insurance system. Daily breakout sessions allowed the participants to work in small groups to discuss the various social insurance and pension issues in an Egyptian context. These breakout sessions included discussions of the role of informal and voluntary systems, developing private pensions, and identifying challenges and new opportunities for Egypt's social insurance system.

Phase II was titled "Issues and Strategies for Investing Pension Funds in a Multipillar Social Insurance System" and was conducted from September 17 to October 11, 2000. As was the case in Phase I, the technical content for each week's program was the same.

The technical content for Phase II included:

- Investment Aspects of a Diversified Multipillar Pension System.
- Overview of Investing in the Financial Markets.
- Returns and Risks in the Financial Markets.
- Investment Companies, Mutual Funds, and Institutional Investors.
- Portfolio Management for Pension Fund Managers.
- Security Analysis for Pension Fund Managers.
- Developing Capital Markets Through Improved Corporate Governance.

Country case studies for Chile, Argentina, and Poland were revisited with a focus on investment performance, investment rules, asset allocations, and investment safeguards and regulations in their newly reformed social insurance systems.

Training activities during both phases included formal presentations by faculty, case studies, breakout sessions, and participant presentations of case studies. Case studies and breakout sessions allowed participants to examine relevant strategies and techniques involved in pension reform and pension management as well as to build teamwork concepts within the groups. Breakout sessions were facilitated and moderated by our local Egyptian consultants, Ms. Noha Bakr and Mr. Maged Mansour. Mr. Mansour also presented sessions on the local Egyptian capital markets in the Phase II training.

The case exercises enabled the participants to apply the principles learned in the presentations to real life issues posed in Egypt. The cases were oriented to helping the participants understand how financial markets work, how financial markets can be harnessed by pension plans to increase returns and to lower contributions while managing risks, and to focus on the regulatory issues that they would need to address as potential regulators (a role that pension reform would call on them to play.) Specific case studies included:

- ❖ Asset Allocation: This case asked the participants to recommend asset allocations for a pension plan for 3 people at different stages of life. The participants were successful in identifying the correct asset allocations.
- ❖ "Pyramid Enterprises: To buy or not to buy?" This case asked the participants to imagine that they were portfolio managers, and to use the techniques of securities analysis, to decide whether to buy shares in Pyramid Enterprises. Participants used valuation techniques such as the dividend discount model, price/earnings ratios, and price/book ratios. The purpose of this case was also to help participants understand that the value of shares in a firm comes from its ability to generate cash in the future, and to pay dividends from this cash flow.
- ❖ "Pension Reform in Xlandia": This case asked the participants to draw together the lessons learned from the workshop. The case revolved around the hypothetical country of Xlandia that faced many problems with its social insurance system and its economy. The groups adopted different approaches, but were consistent with best international practices as identified in the workshops, such as refocusing Pillar 1 to concentrate on poverty alleviation, building a Pillar 2 of individual, mandatory, defined contribution plans, and expanding Pillar 3 to include defined contribution plans.

We had about 35-40 different participants each week in Phase I and about 25-35 different participants each week in Phase II. Participants were drawn from the Ministry of Social Insurance, Ministry of Finance, Ministry of Economics, Ministry of Planning, Capital Markets Authority, and National Investment Bank.

The faculty who participated in Phase I and/or Phase II training activities included Dr. Joe Anderson, Mr. John Chapman, Dr. Michael McLindon, Dr. Gary Powell, and Mr. David Rajnes. In addition, we had several invited faculty who made presentations including Mr. John Noonan, Consultant, Capital Markets Development Project, Mr. Maged Mansour, Financial Analyst, FinBi, Mr. Ahmed Abu Ali, Lawyer, Hassouna and Abu Ali Law Firm and Mr. Hisham Tawfik, Managing Director, Egyptian Portfolio Management Group.

On October 15, Gary Powell, Michael McLindon, Noha Bakr, and Yomna Mustafa made a briefing presentation to USAID. The TAPR team summarized the main points in a Powerpoint presentation. The presentation was well received by USAID.

Participant Evaluations and Discussion

The participants were surveyed at the end of each workshop in both Phase I and Phase II to learn their views about the workshop. Participants were asked the following questions:

1. What is your general evaluation of the workshop?
2. What is your evaluation of the materials distributed during the workshop?
3. How well were expected goals achieved in this program?
4. Would you advise your colleagues of the same post to attend the program?
5. What is your general impression of the program management and organization?

Participants were also encouraged to enclose any general comments or suggestions regarding the workshops. The majority of participants rated the workshops very highly. Nearly all participants gave ratings in the highest two categories for all five questions.

It was particularly interesting to note the changes in the attitudes and beliefs of many participants over time. During the beginning of the workshops in Phase I, some participants voiced skepticism over the need to consider enhancements to Egypt's SIS. Some wondered why an American team of consultants was involved in assessing changes to the SIS? Others wondered about TAPR's involvement in assessing Egypt's SIS. Significant time was devoted to building trust among participants that the TAPR and the American consultants' involvement was aimed to help Egyptian officials and experts themselves assess Egypt's SIS to determine whether enhancements were necessary and which enhancements would work best in an Egyptian context.

It was rewarding to note that, by the end of Phase II, many of the same participants who questioned our involvement in assessing Egypt's SIS were then asking for our ideas of how to enhance the SIS in Egypt.

We cannot say, however, that there was universal agreement among participants that SIS funds should be invested in Egypt's capital markets, especially the Egyptian stock market. Some participants believe such investments to have excessive risk for a social security or pension fund. Their views are not surprising, especially given the weak performance of the Egyptian stock market in the past year. We often countered that this argument makes a strong case for the introduction of personal defined contribution accounts where risk-averse investors can choose to invest their funds in relatively low-

risk investment funds that invest primarily in low-risk government securities (or other high-quality, low-risk investments), while other less-risk averse investors can invest their funds in moderate risk investment funds that invest in (approved) securities that face higher risks and offer higher expected returns including corporate bonds and stocks. Many participants also objected to the concept of allocating any pension fund investments to international stocks and bonds. The consensus of many was that, given the need to attract investment funds to Egypt's capital markets, restricting the investment of pension funds to domestic investments was necessary, especially in the short run.

Many participants recognized the pending challenges to Egypt's SIS based on demographic changes that are expected in the next few decades. The advantages of a diversified, multi-pillar pension approach with personal defined contribution accounts (Pillars II and III) were well received. Many participants seemed particularly interested in whether many of the reforms adopted in other countries such as Chile, Argentina, and Poland would work in Egypt. Most participants recognized that the development of Pillars II and III and investing pension funds in Egypt's capital markets could have synergistic benefits for both Egypt's SIS as well as for the development (broadening and deepening) of Egypt's capital markets.

However, based on the discussions at the concluding policy workshop held on February 26, 2001, it is clear that several of the more senior officials at MOSI do not believe that changes in the existing pension system are needed at this time.

Recommendations For Follow-Up Activities

In many respects, Egypt is in an enviable position. Egyptian officials have recognized the pending challenges to their SIS and have investigated possible enhancements prior to the development of any serious financial strains. However, as discussed in the TAPR report issued in late 1999, the financial soundness of Egypt's SIS is weakening. Growth rates in pension benefits have exceeded growth rates in contributions in recent years by substantial amounts. Demographic changes will also likely begin to exert financial pressure on Egypt's SIS in the near future.

The TAPR report (chapters 6 and 7) specifies a detailed scope of work for addressing the challenges facing Egypt's SIS by the design and adoption of a multi-pillar pension system. The recommendations include the development over time of personal defined contribution pension plans in Egypt. These would become an essential part of the mandatory (Pillar II) and voluntary (Pillar III) systems that could comprise Egypt's future SIS. The current pay-as-you-go, defined benefit system operated by MOSI would be enhanced to provide the necessary old-age poverty alleviation that is essential in a Pillar I system. Timely adoption of the recommendations for enhancements in the TAPR report will ensure that Egypt's SIS will continue to provide the safeguards for alleviating old-age poverty in Egypt that it has for many years and, in addition, will begin to provide

additional savings for retirement for Egypt's working population. These recommendations will also avoid the development of unmanageable financial burdens on the government budget of supporting an unchanged pension system.

Conclusion

This report has summarized the activities related to the two phases of training programs on Social Insurance Reform in Egypt that were conducted during May and from mid-September to mid-October in Cairo. These training programs were funded by USAID under the TAPR technical assistance program. This report focused on the training objectives and activities, participant evaluations, and recommendations for follow-up activities. These training programs were funded by USAID and conducted by a team of local and foreign consultants under the TAPR technical support project.

A central theme in these training programs was the advantages of a diversified, multi-pillar approach for providing social insurance that includes mandatory and voluntary private pension plans with personal, defined contribution accounts. The introduction of these funded pension contributions plans also has the benefit of strengthening the capital markets by contributing to their broadening and deepening. The training conducted in this phase of activities focused on enhancing the skills of officials and workers involved in Egypt's current social insurance system and preparing them for implementing such an approach in Egypt.